See me
Federal
Reserve Board

1. We are facing grave situation about which I am greatly concerned.

2. I have asked you to come in to discuss this crisis with you.

3. It is vitally important that the financing of the defense mobilization program be assured by a stable Federal Securities market.

CHM.

4. Shortly after the invasion of South Korea, I discussed this matter with Tom McCabe and was assured that the Federal Reserve would support the Treasury refinancing program which I had approved for September and October.

5. On several occasions since then I have talked with him about this matter and have been assured of support for the 2½% long-term rate structure.

6. The most recent date on which I was advised that the Treasury would receive such support for both refunding and new money issues was just two weeks ago.

7. It is with considerable surprise, therefore, that I have been readingof criticism by Federal Reserve Officials of the Treasury announcement of the defense mobilization financing program.

8. In view of critical times, I am requesting full support of your group for the Treasury program as announced. I will not discuss details as they are well known to you. I know that I can rely on you for this support as you have been able to renderthis service to your Government so ably in the past.

No evidence of anti-inflationary effects on commercial credit of interest rate changes in past year.

Uncertainty very unsettling.

CHRONOLOGY OF EVENTS RELATING TO THE GOVERNMENT SECURITY MARKET

1. June 25 -- The Republic of Korea is invaded.

2. June 26 -- Secretary Snyder conveys to the Open Market Committee through the Fiscal Assistant Secretary his feeling that "Everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance."

3. June 27 to July 17 -- Federal Reserve ignores the Secretary and continues to sell long bonds in the market. In 13 trading days, the Federal Reserve sells over $300 million of long-term bonds.

4. July 12 -- McCabe writes the Secretary that, instead of stability, continued pressure should be placed on the Government security market in order to reduce bank credit.

5. July 17 -- Secretary replies to McCabe, calling again for stability in the Government bond market and explaining his reasons therefor at some length. (Copy attached.)

6. July 17 to August 10 -- Federal Reserve continues to put pressure on Government security market, selling $600 million of long-term bonds in 18 trading days.

7. August 10 -- McCabe and Rouse meet with the Secretary. McCabe expounds on problem of preventing inflation. Talks about higher discount and short-term interest rates, and further pressure on the long-term market. Secretary reiterates the necessity for stability in the Government security market during international crisis. McCabe requests another conference to discuss the matter with the Secretary further, and this is set for August 18.

8. August 10 through August 18 -- Federal Reserve continues pressure on long-term bond market, selling $145 million of long bonds in 7 trading days.

9. August 18 -- McCabe and Sproul tell the Secretary that the discount rate is to be raised by 1/4 of 1 percent and rates in the short-term market are to be tightened generally; and they hope that the Secretary by his action on the refunding will support their decision. Following the meeting, the Secretary announces the September-October refunding, as approved by the President, and advises the Federal Reserve thereof. McCabe checks proposed discount rate increase with the President, who tells him that he doesn't want Government security rates raised.

10. August 21 -- Federal Reserve raises interest rates in the entire short-term Government security market. Billions of dollars of Government securities go to a discount in the first half hour of trading.

11. August 24 -- Secretary informs President of the situation in the market. President talked to McCabe about it and sent him a letter calling for the maintenance of confidence in the credit of the United States and stability in the Government security market. McCabe returned the letter to the President, assuring him, however, that his request would be carried out.

12. October 2 -- McCabe and Sproul meet with the Secretary and advise him that they are going to raise short-term rates further. (The one-year rate had already been raised from a 1-1/4 percent to a 1-3/8 percent basis.) This is confirmed by letter on October 16. This letter assures the Secretary, however, that "these actions will not affect the maintenance of the 2-1/2 percent rate for the outstanding longest term Government bonds."

13. October 17 - Federal Reserve starts to raise yields on short-term Treasury issues further. One-year rate rises to nearly 1-1/2 percent within a few days.

14. October 26 - Meeting at the White House between the President, Secretary Snyder, and Chairman McCabe. McCabe finally agrees to prevent short-term rates from going up further and, "for the present," to maintain the one-year rate at 1-1/2 percent. This is confirmed by letter on October 30.

15. November 17 - McCabe gives Secretary the Federal Reserve views on December-January financing, proposing a five-year, 1-3/4 percent note. Secretary agrees to go along with McCabe so long as the financing can be done within the pattern of 1-1/2 percent on one-year securities and 2-1/2 percent on long bonds.

16. November 24 - Federal Reserve allows market to go off sharply as result of November 22 announcement of December-January financing. Unsettles market psychology further by dropping price on Victory Loan issue 2/32 during the day.

17. December 1 - Secretary Snyder sees the President and tells him about developments in the market. The President calls McCabe and discusses the matter with him.

18. December 19 - McCabe advises the Secretary that the Board had further measures for credit control in mind, specifically, raising reserve requirements and increasing margin requirements on securities. The Secretary tells McCabe he doesn't think these moves will do much toward controlling credit and makes it clear to McCabe that he wants stability in interest rates. McCabe assures the Secretary that he does not have further interest rate changes on Government securities in mind.

19. December 26 - Federal Reserve reduces the price of the Victory Loan issue from 100-23/32 to 100-22/32. This unsettles the market and causes much conversation as to whether the Government really proposes to maintain the 2-1/2 percent rate.

20. December 28 - McCabe advises the Secretary that the Federal Reserve has taken action to raise reserve requirements; tells the Secretary further that the Federal Reserve proposes to reduce the buying price on Victory Loan 2-1/2s, allowing them to go down 1/32 a day. He mentions a floor of 100-8/32 and then suggests a range of between 100-4/32 and 100-8/32 for this issue. The Secretary tells McCabe he wants stability maintained in the long-term market.

21. January 3 -- The Secretary meets with McCabe and Sproul, who outline a program which would involve a complete reorientation of debt management policy. They propose a program of higher interest rates, particularly in the long-term area. They also want higher interest rates on savings bonds.

22. January 17 - Joint conference between the President, the Secretary, and McCabe to discuss the defense financing program, at which time it is agreed that market stability is essential and that, therefore, the 2-1/2 percent rate on long-term Government bonds shall be maintained, and that refunding and new money issues will be financed within the pattern of that rate.

23. January 18 - Secretary's speech before the New York Board of Trade announcing a policy of market stability and stating that during the defense period refunding and new-money issues will be financed within the pattern of the 2-1/2 percent rate.

24. January 22 - Sproul makes a speech before the New York State Bankers Association, attacking Secretary Snyder's statement on defense financing and market stability policy.

25. January 25 - Eccles testifies before the Joint Committee on the Economic Report and strongly criticizes Treasury financing policy.

26. January 29 - Federal Reserve reduces the buying price on Victory Loan 2-1/2s to 100-21/32. In order to assure market stability, Secretary authorizes the Federal Reserve, as fiscal agents, to purchase this issue for the account of the Postal Savings System at 100-22/32 -- the price that had existed up to 2:00 p.m. on this day.

27. January 30 - Federal Reserve fails to cooperate with Treasury action. Terminates open-market purchases of Victory Loan 2-1/2s and buys $33 million of this issue for Postal Savings account.

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Throughout the entire period, the Federal Reserve continuously circulated rumors about imminent increases in short-term interest rates and in reserve requirements. It encouraged talk about the necessity for a "supported" bond market. This type of behavior kept the market in a constant state of confusion and unsettlement as to where the Federal Reserve was going to take the Government bond market. It was particularly unsettling, since it came on top of continual sales of long-term Government bonds from the Open Market Account, which amounted to nearly $2-1/2 billion between the beginning of the year and the end of August. All of this led to the belief that the Treasury would be issuing a higher rate, long-term issue in the near future.

C
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P
Y

July 17, 1950

Dear Tom:

Thank you very much for your letter of July 12, expressing your thoughts and those of the Executive Committee of the Federal Open Market Committee with respect to new financing and the current situation in the Government bond market.

As I asked Mr. Bartelt to transmit to the Open Market Committee on June 26, I feel that everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance. The firmness with which the market has withstood the impact of the events of the past three weeks is certainly a testimonial to good management. It is also the best possible evidence of the confidence which has been built up in our ability and determination to maintain a stable market for Federal securities.

I know you will agree with me that it is of the utmost importance at the present time to maintain that confidence and, in addition, to do everything possible to strengthen it. This involves, first of all, avoiding any course which would give rise to a belief that significant changes in the pattern of rates were under consideration. The operations of the Open Market Committee since the beginning of the crisis have been well adapted to this end.

As I have studied the situation, I have become convinced that present circumstances call for one further precaution which is, perhaps, of even greater importance than maintaining a good balance in current market operations. In my view, we must take extreme care to avoid introducing any factor which would run the risk of producing unsettlement in the broad market for Federal securities represented by investors throughout the Nation. It is my belief, in particular, that no new financing program should be undertaken at the present time without maximum assurance that it will be well received and can be carried through to a successful conclusion.

Our future tasks, whatever they may be, would be made very much more difficult by anything less than 100 percent success in a program for raising new money. In my judgment, we can not attain the maximum assurance of success until the outlook with respect to both the international and the domestic situations has become considerably more clarified.

At present, the defense needs which may have to be financed in the near future are not known. Our expectations as to revenues are also subject to considerable change as the situation develops. For these reasons, as you know, I recommended that the Congress postpone action on the tax bill now under consideration in the Senate Finance Committee. The same basic considerations lead to my strong belief that no new financing program whose reception is to any considerable extent unpredictable should be introduced into the market at the present time.

There are, of course, occasions which call for quick and bold action. These occasions have occurred with respect to the Federal security market and they may occur again. But every appraisal of the present situation indicates that the maintenance of stability should take priority over all other market considerations. A stable and confident situation in the market for Federal securities is our first line of defense on the financial front, no matter what may be ahead of us.

As you know, developments in the Government bond market have repercussions which fan out through the entire economy. Both the size and the wide distribution of the Federal debt are unprecedented in comparison with the situations which faced us at the start of other periods of crisis. Under these circumstances, we have an obligation of the highest order not only to maintain the finances of the Government in the soundest possible condition, but also to fulfill our responsibilities to the millions of Federal security holders throughout the Nation.

There is one further consideration which confirms my view that the present situation calls in the highest degree for caution and prudence. During the present stage of the emergency, it is vital to make use of every opportunity for assuring our citizens that those at the head of their Government have a strong and steady hand on the helm. The response of the Nation to the President's courageous action in the Korean crisis was one of the greatest demonstrations of unity that we have ever had in this country. The Nation is now waiting to learn what domestic programs may be needed in order to utilize our full strength in the interests of national defense. When these programs are brought forward, it will take time for the public to assimilate them. In view of these facts, it is of the utmost importance that no action be taken at the present time which could be construed in any sense as anticipating proposals for defense which may later be outlined by the President.

In short, every circumstance at the present time calls for steadiness and manifest strength in the Federal security market as a primary measure of economic preparedness. That is the net of the situation as I see it. And, as you will note, I am sending my thoughts on to you just as they have occurred to me, in order to let you know the course of my thinking as events unfold.

Sincerely yours,

(signed) JOHN W. SNYDER

Secretary of the Treasury

Honorable Thomas B. McCabe
Chairman, Board of Governors of
the Federal Reserve System
Washington 25, D. C.